

Service Date: April 22, 1986

DEPARTMENT OF PUBLIC SERVICE REGULATION  
BEFORE THE PUBLIC SERVICE COMMISSION  
OF THE STATE OF MONTANA

IN THE MATTER of the Application ) UTILITY DIVISION  
of the BUTTE WATER COMPANY for ) DOCKET NO. 86.3.7  
Authority to Increase Rates and ) ORDER NO. 5194  
Charges for Water Service to its )  
Butte, Montana Customers. )

INTERIM RATE ORDER  
FINDINGS OF FACT

1. On March 7, 1986, Butte Water Company (Applicant or BWC) filed an application with this Commission for authority to increase water rates for its Butte, Montana customers on a permanent basis by approximately 16.08 % which constitutes an annual revenue increase of approximately \$485,335.

2. Concurrent with its filing for a permanent increase in rates BWC filed an application for an interim increase in rates of 16.08% equalling a revenue increase of approximately \$485,335 or 100% of the proposed permanent increase.

3. The interim rate request includes adjustments not accepted in total or in part in previous Commission orders, such as: Cost of Equity, Cost of Debt, Projected Labor Costs, Power Cost Increases due to Additional Pumping from the Big Hole and projected Montana Power Rate Increase, Cost of Living Adjustment for Wage Earners, Property Rights Verification and Income Taxes.

4. The Commission's interim rules and guidelines call for a clear showing that the petitioning utility is suffering and obvious income deficiency. Generally the Commission would

find that reference to adjustments and rate of return approved in the most recent BWC general rate order would provide the most appropriate means to measure BWC's financial performance. But in this instance the Commission finds that approach to be inappropriate because of the significant change in the Applicant's financial information resulting from the sale of BWC stock.

5. The Commission for purposes of determining a need for interim rate relief will allow a hypothetical rate of return and make adjustments that appear to be of an uncontested nature. Applying these parameters to current test period operating income and rate base, sensibly annualized and corrected for accounting errors, should avoid prejudging issues in the current case.

6. Since a sale of 100% of BWC's common stock took place on December 18, 1985, the Commission decided, that prior to the granting of any interim rate relief in this Docket, an audit of the information contained in the Applicant's filing should be conducted by the Commission staff. The Commission staff during the period March 17, 1986, through March 28, 1986 conducted an audit of BWC's records in their offices in Butte and some of the information gleaned from that audit is incorporated in this interim order.

7. The Applicant for rate case presentation provided the following capital structure and overall cost of capital:

				Weighted
Description	Amount	Ratio	Cost	Cost
Debt	\$2,000,000	51.67%	12.00%	6.20%
Equity	<u>1,870,653</u>	<u>48.33%</u>	<u>14.75%</u>	<u>7.13%</u>
Total	3,870,653	100.00%		

Composite Cost of Total Capital 13.33%

8. Before the Commission can determine whether or not the Applicant is incurring an obvious income deficiency it must establish an interim return requirement for the utility. Establishment of a return requirement for the utility, absent a recent Commission order establishing a cost of capital for the utility on the capital structure presented, places the Commission in the position of having to make a determination without prejudging the issues in this Docket.

The Commission is of the opinion, that for purposes of interim rate relief determination, the cost of capital should be placed at a conservative level which affords the Applicant a reasonably adequate return.

9. At the present time the debt capital of the Applicant consists of a short-term note payable from Midwest Federal Savings and Loan Association of Minneapolis. The Applicant has indicated that it is in the process of rolling this note over into a long-term obligation and is negotiating with several lending institutions but, as yet, has not finalized the terms and conditions of the long-term obligation.

For the purpose of establishing a cost of debt, on an interim basis, the Commission staff requested that the Applicant provide preliminary details of the terms and conditions that have been discussed with lending institutions. On April 4, 1986, the Commission received a letter from a Company representative which contained a copy of an initial proposal from one of the institutions. This proposal indicated that the lending institution was willing to lend BWC \$2,000,000 for a term of seven (7) years at an interest rate of 1 percent above the prime rate of interest.

10. For purposes of this order the Commission finds that it is appropriate to use the lowest available prime rate of interest, 8.75% percent, plus a 1 percent adder, in determining a cost of debt for the Applicant. The Commission predicates this 1 determination on the terms and conditions outlined in the initial loan proposal received by the Applicant and uses the lowest available prime rate of interest to avoid prejudging the issue and to maintain a conservative posture in the grant of any rate relief.

11. The determination of the Applicant's interim cost of equity is a more difficult issue to address. Ascertaining a cost of equity, which is to some degree subjective in nature, presents the problem that reasonable people given the same set of data can develop vastly different requirements for the cost of equity. Given the difficulties inherent in a cost of equity determination the Commission is of the opinion that it should grant a return which is lower than that requested by the Applicant in its filing. The Commission, for interim purposes, finds that the grant of a 12 percent return on equity is reasonable given current economic conditions and the fact that this item is generally a contested issue.

12. The Commission for interim rate purposes finds the following capital structure and composite cost of total capital to be reasonable:

Description	Amount	Ratio	Cost	Weighted Cost
Debt	\$2,000, 000	51.67%	9.75%	5.04%
Equity	<u>1,870,653</u>	<u>48.33%</u>	<u>12.00%</u>	<u>5.80%</u>
Total	\$3,870,653	100.00%		

Composite Cost of Total Capital

10.84%

12. A schedule prepared consistent with the criterion outlined in Finding of Fact No. 5 shows that BWC operations for the test period produced an overall rate of return of 7.96% (Schedule 1). This compares with the overall rate of return found reasonable for interim purposes of 10.84%.

#### Schedule 1

Net Income Adjusted to Current Rates 288,003

##### Annualized Adjustments:

Employee Change	(10,955)	P.157.2
Allocate Medical Expense - Ana.	(7,230)	P.157.3
Allocate Workers Comp. - Ana.	(106)	P.157.3
Allocate R.D.& D. - Ana.	(281)	P.157.3
Increased Water Treatment	18,000	P.157.5
Increased Salaries	15,216	P.157.5
Free Water Revenue	(4,147)	P.164.3

Depreciation	10,370	38.5.165
Taxes Other Than Income	(374)	38.5.173
Total Accepted Adjustments	20,493	
Total Adjusted Net Income	267,510	
Total Rate Base	3,361,329 *	
Rate of Return	7.96%	
Allowed Rate of Return	10.84%	
Required Earnings	364,368	
Earnings Shortfall	96,858	

\* The rate base in schedule 1 has been adjusted to reflect a decreased cash working capital allowance because of lower operation and maintenance expenses in the interim increase determination.

13. The Commission finds that this difference constitutes an obvious income deficiency, in this instance, that deferred rate relief until a final order can be issued

may adversely affect the utility's financial condition and further that under its current ratemaking standards, the utility may be entitled to rate relief at the time a final order is issued in the proceedings.

14. The Commission finds that BWC's rate of return is below that which has been found to be reasonable and accordingly, finds - BWC entitled to interim rate relief of \$96,858 on an annual basis. (See Schedule 1, Finding of Fact No. 12)

15. The Applicant has requested that any interim relief determined appropriate by the Commission be generated by increasing the rate for all services provided by the Applicant on the basis of a uniform percentage increase. The Commission finds the Applicant's request for a uniform percentage increase, applicable to all service charges, to be reasonable.

#### CONCLUSIONS OF LAW

1. The Butte Water Company is a public utility furnishing water service to customers in the Butte, Montana area. As such, it is subject to the supervision, regulation and control of this Commission pursuant to 69-3-102, MCA.

2. Section 69-3-304, MCA, provides in part, "The Commission may in its discretion, temporarily approve increases pending a hearing or final decision.

3. The Commission concludes that the grant of an interim rate increase in the manner set forth herein is just, reasonable and within the discretion granted by Section 69-3-304, MCA.

ORDER

NOW THEREFORE, IT IS ORDERED THAT:

1. The Butte Water Company is hereby granted authority to implement on an interim basis increased rates for its Butte, Montana customers, designed to generate additional annual revenues in the amount of \$96,858.

2. The Butte Water Company is to file revised tariff schedules spreading the increased revenues as a uniform percentage increase to all services.

3. The increase granted herein is subject to rebate should the final order in this Docket determine that a lesser increase is warranted. Such rebate would include interest at 12.0% per annum.

4. The interim relief granted in this Order is to be effective for services rendered on and after April 21, 1986

DONE IN OPEN SESSION at Helena, Montana, this 21st day of April, 1986, by a vote of 4to 0 .

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION

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John B. Driscoll, Commissioner

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Clyde Jarvis, Chairman

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Howard L. Ellis, Commissioner

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Danny Oberg, Commissioner

ATTEST:

Trenna Scoffield Secretary

(SEAL)

NOTE: Any interested reconsider this filed within ten party may request the Commission to decision. A motion to reconsider must be (10) days. See 38.2.4806, ARM.